

General Information Letter: Nonresident partner must allocate to Illinois its partnership share of business income apportioned to Illinois by the partnership.

March 21, 2007

Dear:

This is in response to your letter dated February 12, 2007. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 86 Ill. Adm. Code 1200.120(b) and (c), which may be found on the Department's web site at www.tax.illinois.gov.

In your letter you have stated the following:

This letter is in response to your letter dated September 12, 2006 regarding the Illinois filing status of the partners of COMPANY1, LP (COMPANY1). In reviewing the Illinois law and cases referenced in the letter, COMPANY2, LP (COMPANY2)'s fact pattern is somewhat different from those referenced. In the Administrative Hearing Decision IT-95-3, the taxpayer is an Illinois resident that has investment income in STATE. The Department of Revenue of the State of Illinois argued this investment income needed to be taxed to the taxpayer's state of commercial domicile. We agree. In COMPANY2's case, the investment income from COMPANY1 was taxed in their state of commercial domicile which is not Illinois. The case referred to above then discusses whether the investment income was business or nonbusiness income within the law of the state of Illinois. Since Illinois is not COMPANY2's state of commercial domicile, there is no reason to determine if the income is business vs. nonbusiness within the state of Illinois. That determination is made according to the law of COMPANY2's state of commercial domicile.

The structure of COMPANY1 as a hedge fund provides that its investors are only operating a pool of intangible investment assets. COMPANY1 in and of itself does not generate any operating income. Rather, it pays the general partner a fee to manage the portfolio and generate the income on behalf of the partnership. That general partner *is* operating an ordinary trade or business within the state of Illinois because it is generating management fee income, and should file an appropriate tax return and pay the tax on its income. COMPANY2 is not the general partner of COMPANY1 and therefore does not have a filing obligation in the state of Illinois.

COMPANY2 was a nonresident for all of the 2003 tax year and was not affiliated with any business activity within the state, including its investment interest in COMPANY1. Therefore, COMPANY2's Illinois apportionment factor was zero because they did not earn income from any Illinois sources. In addition, the IL Sch. K-1-P received from COMPANY1 shows no amount in Column B, the nonresident member's share of income allocable to Illinois, which indicates no Illinois income was earned from COMPANY1 that COMPANY2 is responsible for. As a result, no 2003 Illinois and/or replacement tax is required to be filed by COMPANY2. Please adjust your records accordingly.

Response

I have attached for your reference a copy of the decision in Administrative Hearing Decision IT-95-3. Please note that this decision did not involve an Illinois resident, who would have been subject to Illinois income tax on all of its income regardless of geographic source. Instead, because its investment income was business income, and it was conducting a portion of its business in Illinois, it was required as a nonresident to apportion some of that investment income to Illinois.

COMPANY1, LP and COMPANY2, LP, as partnerships, are also nonresidents because only individuals, trusts and estates can be residents under Section 1501(a)(20) of the Illinois income Tax Act (35 ILCS 5/1501). Accordingly, all other persons are defined as nonresidents under Section 1501(a)(14).

Section 304 of the Illinois Income Tax Act (35 ILCS 5/304) provides the basic rules for a nonresident to apportionment of business income by a nonresident. On the 2003 Schedule K-1-P you attached, COMPANY1, LP indicated that all of its income distributable to COMPANY2, LP is business income and, on Step 1, Line 4, reported that 100% of its business income is apportionable to Illinois.

Section 305(a) of the Illinois Income Tax Act (35 ILCS 5/305) provides:

The respective shares of partners other than residents in so much of the business income of the partnership as is allocated or apportioned to this State in the possession of the partnership shall be taken into account by such partners pro rata in accordance with their respective distributive shares of such partnership income for the partnership's taxable year and allocated to this State.

Because, as noted above, COMPANY1, LP reported all of the income distributable to COMPANY2, LP was business income, and 100% of its business income is apportionable to Illinois, COMPANY2, LP is subject to Illinois income tax on its share of the income of COMPANY1, LP pursuant to the express provisions of Section 305(a). As a limited partner in a partnership doing business in Illinois, COMPANY2, LP has nexus with the State and is subject to its income tax. See *Borden Chemicals and Plastics, LP, v. Zehnder*, 312 IllApp3d 35 (1st Div. 2000).

As stated above, this is a general information letter which does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b). If you have any further questions, you may contact me at (217) 782-7055.

Sincerely,

Paul S. Caselton
Deputy General Counsel – Income Tax

